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# SELECTION AND APPLICATION OF PRICING STRATEGIES IN RURAL TOURISM: THE CASE OF VOJVODINA'S FARMSTEADS

*Tourism today is a mass phenomenon involving a large number of actors, both on the demand side and on the supply side. For more efficient and better organized performance, tourism companies need to ensure a high quality of service and apply effective pricing strategies. Therefore, the aim of this paper is to outline the key pricing strategies and analyze their advantages and drawbacks. For this purpose we have chosen the specific case of farmsteads in the Province of Vojvodina, Serbia. We focus on the complementary products or services provided by these farmsteads that have a seasonal element to them, that is, they are hard to sell out of season. As a result, we devised guidelines for entrepreneurs to enhance their business opportunities by applying effective pricing strategies such as the 'marginal costs' strategy.*

**Keywords:** strategies, prices, marginal costs, rural tourism, farmstead, Vojvodina province (Serbia).

## Introduction

The competitive position of enterprises operating in tourism industry, especially small enterprises specializing in rural tourism, depends to a large extent on the applied concept of their growth and development, i.e. on the establishment and implementation of an adequate strategy [1, 2, 3]. Therefore, to devise an efficient and dynamic strategy, these enterprises need to take into account both internal and external factors such as the level of the company's development and the market in which it is operating.

The term 'strategy' is used so widely nowadays that in practice its significance sometimes seems overrated. Everything that is 'important' in an enterprise tends to be referred to as 'strategic', which makes this concept too broad and, therefore, useless as it confuses more than it clarifies. Moreover, it is often misleading in the sense that it emphasizes the elements and aspects which are not crucial for the company. Ideally, a strategy should provide a framework for the company's business for better coordination and more efficient management in order to make the company more responsive to the changing environment [4]. The strategy should articulate the desirable relationships between the company and its environment, take into account the specific nature of the business sector and thus help the company's management plan, structure and organize the company's business activities accordingly [5].

Based on those assumptions, every strategic decision contributes to the successful performance of the company. All strategic decisions can be divided into two categories: fundamental and applied. It should be noted here that fundamental or the so-called corporate strategies are based on decision-making associated with, for instance, creation of new products. Strategies dealing with the implementation of such decisions (e.g. how to set prices or advertise the new product) can be called applied or business strategies. In this paper, we will primarily focus on those corporate and business strategies that can be applied in small enterprises [6], more specifically, the pricing strategies of rural tourism companies, since they have more pronounced peculiarities in the production and marketing phases. These strategies should support the portfolio product / market, i.e. should be applied within small companies in the phase of production and distribution to the final consumer.

## Material and Methods

Our research was conducted at farmsteads in the Autonomous Province of Vojvodina, Republic of Serbia. The initial stage consisted of interviews with entrepreneurs, who were managers at nine farmsteads. At the second stage, we analyzed the collected data and used them for devising guidelines for entrepreneurs. The age of our respondents ranged from 22 to 64; the average age was 43. The majority (72%) had secondary education; about 12%, higher; and 16%, elementary education. In addition to the interviews, we gathered and analyzed the information about the products and services that these companies were providing to rural tourists, their methods and strategies of calculating the prices and the mutual compatibility of products/services as well as the problems that entrepreneurs faced in sales. The results were calculated for each individual farmstead and on average for the set of farmsteads we studied.

In the paper two concepts are used to determine the appropriate price strategy: 'total costs or costs plus' and 'marginal costs' [7, 8]. Each concept takes into account the expectations that appear on the input market, since pricing is based on the analysis of the production costs. We believe that the key factor that determines the success of a small business is the sales market.

## Results and Discussion

In this section we are comparing the results of the application of the two pricing strategies – 'total costs or costs plus' and 'marginal costs'.

### *Fixing the prices by using the strategy 'total costs or costs plus'*

This method of pricing usually includes estimation of the production cost for a product or a service under normal conditions, that is, when there are no fluctuations in capacity utilization, employment or output [9]. The method can be applied to an entire range of products/services and called the strategy of building prices. This procedure is illustrated in Table 1:

Table 1.

**Strategy 'total costs or costs plus'- Suggested selling price**

| All prices in EUR | Product | |
|---|---|---|
| Item | P1 | P2 |
| Direct cost of materials | 5 | 10 |
| Cost of direct manpower | 4 | 2 |
| Direct expenses | 1 | 0 |
| **Prime costs** | **10** | **12** |
| *Additional production costs* | | |
| Variable costs of production | 5 | 5 |
| Fixed costs of production | 5 | 10 |
| **Total cost of production** | **20** | **27** |
| *Marketing and distribution* | *3* | *3* |
| Variable costs | 2 | 1 |
| Fixed costs | 1 | 2 |
| *Additional administrative costs* | *1* | *1* |
| Fixed costs | 1 | 1 |
| **Total costs** | **24** | **31** |
| Pre-determined profit margin (%) | 10 | 20 |
| **Selling price** | 26,4 | 37,2 |
| Marginal costs (total variable costs) | 17 | 18 |

*Source*: authors' calculations

After the implementation of the above-described procedure, we add to the cost of the unit the desired profit of the company. This element is determined according to the company's position in relation to its competitors, usually by calculating the average profit rate of business in this sphere [10]. However, the drawback of this pricing strategy becomes evident when the cost of a particular product or service turns out to be higher than the competitors' market price of the same product or service, which makes it impossible to apply the appropriate profit margin because the product would be too expensive. Therefore, most businesses choose to apply a more widely spread but also more complicated pricing strategy – the strategy of 'marginal cost'.

***Fixing the prices by using the strategy 'marginal costs'***

Pricing based on the 'marginal costs' strategy is a particularly effective method. It provides information that helps companies manage product selection, markets, sales areas, and market segmenting in relation to individual categories of customers [11, 12].

The 'marginal cost' strategy involves the variable costs of a product or a service unit. These are the costs that could be avoided if the product was not produced at all or if the service was not provided. An example of such calculations is given in Table 2. We were using the case of farmsteads working as tourism and catering companies. These farmsteads were run as family ventures. Our calculations illustrate the profit that can be gained by such enterprises if they sell two basic products or services (see Table 3). The assumption is that both products or services are realized, that is, completed and sold to the customer during one calendar year.

Table 2.

**Marginal cost of a product (EUR/unit)**

| **Direct costs per unit** | |
|---|---|
| Materials | 0.70 |
| Staff wages | 0.10 |
| Expenses | 0.25 |
| **Total prime costs** | 1.05 |
| **Additional variable overhead costs per unit** | |
| Production | 0.15 |
| Marketing and distribution | 0.20 |
| Administration | 0.05 |
| Overhead costs | 0.40 |
| **Total additional variable overhead costs per unit** | 0.80 |
| Marginal costs | 1.85 |

*Source*: authors' calculations

Table 3 shows an example of an income statement on the company's performance over a one-year period

Table 3.

**Income statement**

| | Total | Product P1 | Product P 2 |
|---|---|---|---|
| | - EUR - | | |
| Sales | 1.500 | 800 | 700 |
| **Sales revenue** | **23.000** | **16.000** | **7.000** |
| *Direct materials* | *11.500* | *8.000* | *3.500* |
| *Direct labour* | *5.400* | *4.000* | *1.400* |

| | | | |
|---|---|---|---|
| **Prime costs** | **16.900** | **12.000** | **4.900** |
| *Production overhead costs*[1)] | *3.100* | *2.000* | *1.100* |
| **Production costs** | **20.000** | **14.000** | **6.000** |
| Marketing, distribution and Administration costs [2)] | 2.200 | 1.000 | 1.200 |
| **Total costs** | **22.200** | **15.000** | **7.200** |
| **Profit /** loss | **800** | **1.000** | **-200** |
| Estimated allocation of supplementary and administration costs: | | | |
| [1)] variable costs | 1.700 | 900 | 800 |
| fixed costs | 1.400 | 1.100 | 300 |
| [2)] variable costs | 500 | 300 | 200 |
| fixed costs | 1.700 | 700 | 1.000 |

*Source*: authors' calculations

The profit statement shows that the P2 product is selling not very well, which means that the company management might want to consider the question of discontinuing its production. Such decision, however, does not take into account the fact that this product whether produced or not, is bound to certain fixed costs of the company itself, such as the rent of space, taxes, fees, equipment depreciation and the salaries paid to administration. Therefore, the application of the 'marginal cost' strategy should help the entrepreneur get a clearer view of the situation (see Table 4).

As it is evident from the example in Table 3, the P2 product makes a difference of EUR 1,100. This is the amount that the company would lose if the production of this product was stopped. On the other hand, the company's total fixed costs of EUR 3,100 would remain uncovered. Therefore, if the company discontinued the production of P2 product, it would lose about would EUR 300. The previously gained profit of EUR 800, despite the negative result of product P2 sales, would thus be lost if the production of P2 stopped. Although the fixed costs could be reduced by more than EUR 1,100 if P2 was discontinued, Table 3 clearly shows that the optimal decision for the company would be to continue its production.

Table 4.

**Fixing the prices using the strategy 'marginal costs' (as of 31st of December)**

| | total | product P1 | product P 2 |
|---|---|---|---|
| | - EUR - | | |
| **Sales revenue** | **23.000** | **16.000** | **7.000** |
| Less **variable costs** | | | |
| *direct materials* | 11.500 | 8.000 | 3.500 |
| *direct labour* | 5.400 | 4.000 | 1.400 |
| *variable production overhead costs* | 1.700 | 900 | 800 |
| *variable marketing, distribution and administration overhead costs* | 500 | 300 | 200 |
| **Total variable costs** | **19.100** | **13.200** | **5.900** |
| **Contribution** | 3.900 | 2.800 | 1.100 |
| **Less fixed overhead costs** | | | |
| Production overhead costs | 1.400 | | |
| *marketing, distribution and administration overheads* | 1.700 | | |
| **Total fixed overhead costs** | **3.100** | | |
| **Profit /** loss | **800** | | |

*Source*: authors' calculations

The application of the 'marginal cost' strategy creates a combined effect but it also has some limiting factors. The application of this strategy makes it easier to search for a combined effect that is caused by price and cost factors, affecting both profits. In order to illustrate this, it is sufficient to make the company's profit and loss account in two successive years (see Table 5). Changes within the given period result from an increase in the sales price by 20% and from an increase in the volume of products and services sold. Thus, in this case, we need to investigate the effects of individual factors which lead to an increase in the contribution (difference) to EUR 150,000 in the second year.

Each company has one or more limitations. They represent a critical input for business which at some point or during a certain period limits the business [13]. First and foremost, this is the company's selling potential but the limitations can also be associated with certain characteristics of raw materials or production, with the degree of tourist product integration, the skills of the productive workforce, or with the availability of space or working assets [14]. When these limiting factors are introduced into analysis, the profit will be determined by their contributions. Linear programming can be used to investigate each individual influence and choose an optimal plan. This mathematical method successfully addresses cases with a number of limiting factors and interactive variables.

Table 5.

**The combined effect of changing the volume of sales, selling prices and costs**

| - EUR - | Year 1 | Year 2 |
|---|---|---|
| Sales | 200.000 | 400.000 |
| Marginal cost of sales | 100.000 | 150.000 |
| Contribution | 100.000 | 250.000 |
| **1) change related to the volume of sales** | | |
| Sales of year 2 at year 1 prices = 400.000 x 4/5 | | 320.000 |
| Sales of year 1 at year 1 prices | | 200.000 |
| *Change related to the volume = EUR* | | *120.000* |
| *% change in volume (120 : 200) × 100* | | *60%* |
| Sales increase = EUR | | 120.000 |
| marginal costs = EUR 60% × 100.000 | | 60.000 |
| ***Contribution change related to the volume = EUR*** | | ***60.000*** |
| **2) change related to the selling price** | | |
| Sales of year 2 at prices from year 1 | | 320.000 |
| Sales of year 2 at prices from year 2 | | 400.000 |
| ***Contribution change related to the price*** | | ***80.000*** |
| **3) reduction in costs** | | |
| Change in sales volume = (120,000 : 200,000) x 100 | | 60% |
| Marginal costs in year 1 related to the change of volume | | 100.000 |
| Marginal costs in year 2 = 100,000 + (60:100x100,00) | | 160.000 |
| Marginal costs in year 2 | | 150.000 |
| Reduction in costs | | 10.000 |
| **The change in contribution of EUR 150.000 related to the following factors:** | | |
| Volume change | | 60.000 |
| Price change | | 80.000 |
| Cost change | | 10.000 |
| ***Contribution in year 2.*** | | ***150.000*** |

*Source*: authors' calculations

Consequently, it may be concluded that the 'marginal cost' strategy is most suitable for companies operating in unstable economic conditions. In such cases, it is better to accept orders below the level of the

total value of the costs. This recommendation is based on the need to cover the marginal costs, which means that each level of the contribution above the fixed costs will at least reduce the company's losses and help the company stay afloat until better days retaining its staff and preserving its facilities and equipment. Thus, the application of this strategy can help entrepreneurs to set prices [15] in such circumstances as:

(1) economic recession in this business sector;
(2) excess of the company's productive capacity;
(3) seasonal fluctuations of demand;
(4) situations when the company is using the individual employment contract;
(5) situations when alternative levels of business activities are included.

## Conclusion

Starting entrepreneurial ventures in the sphere of rural tourism, such as family farmsteads, is a complex and demanding job, since it requires entrepreneurs to expand their expertise in business and management. It often happens that entrepreneurs lack experience and knowledge when faced with competitive conditions in the target market. There are dozens of farmsteads in Vojvodina province that mainly provide tourist and catering services. According to the research we conducted, most of the managers and owners we surveyed do not have sufficient knowledge in finance and business economics, especially in the sphere of standard and/or experimental pricing methods, so they are struggling to stay afloat. Thus, it can be concluded that to be successful it is essential that entrepreneurs working in this sphere should acquire the appropriate education and skills. Farmsteads that are trying to enter the market and are trying to cope with the unstable environment and seasonal fluctuations in demand need to develop and apply adequate pricing strategies such as the 'marginal cost' strategy.

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